

For Tax Information...for Sale?

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By Gail Buckner, CFP

SENATE

Exhibit No. 1
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Congratulations! You just had your 2005 tax return completed by one of those national tax preparation firms.

Or did you? Although your appointment may have taken place in your home town, it's highly unlikely that the representative you met with actually filled out your return. In fact, there's a good chance it was prepared by someone sitting half a world away: India is the hottest location for tax preparation outsourcing.*

While you're digesting the significance of a perfect stranger in another country having access to your most personal financial data, let me lob another question at you:

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What do you think happens to all of your tax information — Social Security numbers, income, investments, interest payments, property taxes, alimony, medical expenses, etc. — once your tax return is sent to the IRS? Do you think the tax preparation company erases your file from its computers? Shreds all hard copies of your data?

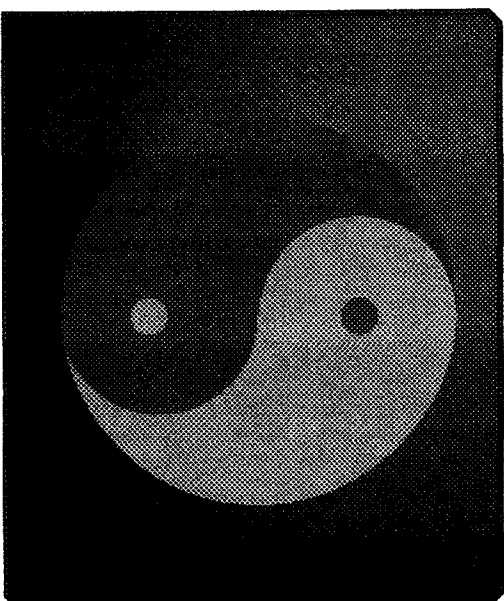
Guess again. Not only is this sensitive information *not* destroyed, there's a very good chance it's already on its way to an affiliated company that will be contacting you soon to offer you a host of financial products — IRAs, home equity loans, 529 plans — you name it. Anything that makes sense based on the information on your tax return.

And it's all *perfectly legal*.

Back in 1974, when tax returns were done by hand and "high tech" meant maybe an adding machine was used to do the calculations, Congress passed a law restricting what a tax preparer can do with the confidential information s/he collects in order to complete your tax return. This became "Section 7216" of the Internal Revenue Code.

Essentially, **Section 7216** prohibits using your tax data for any other purpose other than to prepare your return. But there are exceptions. Section 7216 also lays out the criminal penalties tax preparers face if they make unauthorized use or disclosure of taxpayer information.

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Now, stick with me here. The operative words are "use" and "disclosure."

According to IRS spokesperson Nancy Mathis, "use" is what a tax preparer — with your permission — can do with your return *internally*. This includes sharing your tax information with other departments or "affiliated groups" that are part of the same company.

"Disclosure" is when a tax preparer releases your tax information to an entity *outside* his/her firm, again, with your permission.

One of the exceptions to Section 7216 allows a tax preparer that is incorporated to use your return information to cross-sell you other products or to share your return with sister companies that do this, provided you give your permission.

Jean Ann Fox of the Consumer Federation of America (CFA) says, "H&R Block (HRB) has been marketing financial products based on your tax information — H&R Block mortgages, 'Express IRAs,' and refund anticipation loans —" through other companies under the H&R Block corporate umbrella. According to comments jointly filed by CFA, National Consumer Law Center, and Public Interest Research Group, the CEO of H&R Block has publically bragged about his firm's "ability to exploit confidential tax information."

Although this has been going on for years, consumer groups and members of Congress are turning right now. That's because the IRS has proposed updating the regulations to, in its view, reflect reality: the tax preparation industry has undergone a profound shift in the past 15 years and the widespread use of computers and e-filing have made it a snap to share, aggregate, and distribute data.

Among other things, the proposed changes would *expand* the use and disclosure of sensitive tax information. First, they remove the restriction that only firms that are "incorporated" can use your tax data to sell you other products, or share it with affiliated companies that do this. The IRS's Mathis asserts that the intent of eliminating this requirement is to "level the playing field" so that all tax preparers are treated alike. "Why, because of a 32-year old regulation, should we create monopolies for certain tax preparation companies?", she asks.

Read: Why should a company like H&R Block be allowed to market financial products to you based on your tax return data, but not the "Big Four" accounting firms because they're set up as "partnerships," or the one—person accounting office which is a "sole proprietorship?"

Another proposed change affects the release of taxpayer information to unrelated third parties. While current regulations allow you to *direct* your tax preparer to do so (for instance, "Please send a copy of my tax return to the bank which is evaluating my home equity loan application."), the proposed regulatory change would permit taxpayer information to be released to *any* kind of company for marketing purposes. All it takes is your signature.

This is what conjures up nightmares for privacy advocates and consumer protection groups who envision our confidential financial data getting into the hands of car dealers, database companies, mortgage brokers, debt collectors, identity thieves posing as legitimate businesses—you get the picture.

Moreover, once your tax information is turned over to a third party, there's no longer any legal restriction on what can be done with it because the law only governs what *tax preparers* can do with it.

There's also a strong motivation for tax preparers to encourage clients to "sign on the dotted line." Attorney Chi Chi Wu of the National Consumer Law Center (NCLC) says although the proposed regulations don't specifically use the word "sell," they also don't prohibit a tax preparer from making a profit by disclosing your information. "Nobody's going to give this information away," she says. "It's very valuable."

The IRS maintains that if a tax preparer planned to sell your data, this would have to be disclosed on the consent form. In addition, the IRS proposal would significantly beef up the consent document by requiring a sober warning about the potential consequences, in a way that, in Mathis' words, "could not be buried in the fine print." The IRS would also set a one-year limit on how long your consent remains in effect—something completely missing from current regulations.

From the standpoint of the IRS, the real question is who controls taxpayer information that is in the hands of the preparer or software company? "Should the IRS bar taxpayers from doing what they want?" says Mathis. "Or should we say 'You control and own your tax information. But if you're going to be disclosing this, you need to think twice.'"

Consumer advocates applaud the idea of stronger disclosure language, but question whether taxpayers really read and understand all of the paperwork that's shoved at them at tax time. They're afraid that many people, especially those who are low-income or illiterate, will simply sign anything their "trusted" tax preparer tells them to.

Gus Maldonado, product manager with **McAfee**, a leader in security software, says "There's a fine line between identity theft and identity acquisition." He adds, "We don't see any appropriate situation where you would share your tax information with anyone but your tax preparer."

Indeed. Wouldn't you feel more secure knowing that tax preparers of all types — from large corporations to small CPA firms — are prohibited from using your personal data for any other purpose than preparing your tax return? Why should any of these firms be allowed to sell you a financial product based on the sensitive information you have entrusted them with?

"Any cross-selling based on tax information — we don't think that's a good idea," says NCLC's Wu.

"That's a debate to have," says Mathis of the IRS.

I say: Bring it on. Either build in tough consumer safeguards, big penalties for violations, and make all tax preparers play by the same rules or quit pretending that taxpayer information is really "confidential."

It remains to be seen whether Congress has the guts to take a stand on this. Lobbyists are probably already lining up at the Capitol to argue that tax preparation firms that cross-sell other products to clients are providing a valuable and convenient "service."

But before you dash off an email to me to share your outrage about this, do us both a favor: First let your senators and representative know how you feel. They've got email addresses, too. They're also the only ones who can really do something about this issue.

Of course, your alternative is to complete your own tax return next year.

Gail

**The IRS proposal would also require written consent in order for your tax return to be completed by individuals outside the U.S.*

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